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Protecting workers: Minister Blackburn moves forward on Wage Earner Protection Program and insolvency reforms

OTTAWA, ONTARIO, JUNE 14, 2007 — Today, the Honourable Jean-Pierre Blackburn, Minister of Labour and Minister of the Economic Development Agency of Canada for the Regions of Quebec, is pleased to announce that Canada's New Government is moving forward with legislation that will help workers and reform Canada's insolvency system.

"Canada's New Government supports Canadian workers and their families, and this legislation will protect the wages of people who work hard for their money," said Minister Blackburn. "This legislation will ensure that workers get their money when they need it the most. We are proud to move forward with a bill that will benefit all workers across Canada," added Minister Blackburn.

On November 25, 2005, *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Act* received Royal Assent and became Chapter 47 of the Statutes of Canada, 2005. Chapter 47 represents a comprehensive reform of Canada's insolvency system designed to ensure that it better responds to the needs of business, consumers and investors.

An important part of these reforms was the creation of the Wage Earner Protection Program (WEPP), which protects workers when employers become bankrupt or are subject to a receivership. It provides for the payment of unpaid wages and earned vacation pay of up to an amount equaling four weeks' maximum insurable earnings under the *Employment Insurance Act* (or approximately $3,000 at this time). It was understood prior to Royal Assent that the legislation would be subject to further review to resolve some technical issues before coming into force. Bill C-62 contains amendments to Chapter 47 to address these issues.

Technical amendments that fine tune and improve the WEPP Act to ensure that it will function well include provisions to enhance the fairness of the conditions of eligibility, support to trustees and receivers, and other administrative matters. Other provisions that improve the bankruptcy and insolvency reforms are related to the powers of receivers, personal liabilities of insolvency professionals, transfer at undervalue provisions and student loans.

Information on the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* is available online at www.strategis.ic.gc.ca. Information on the Wage Earner Protection Program may be found on the following Web site: Labour.gc.ca.

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Media Only

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Backgrounder

Government Proposes Reform of Insolvency Legislation and the *Wage Earner Protection Program Act*

The Importance of Insolvency Laws

Canada's insolvency laws have a significant impact on the economy. They influence a number of economic factors, including the redeployment of resources to productive uses, the cost and availability of credit, corporate restructurings and structural adjustment. As such, they are an important part of our framework legislation and play a key role in Canada's competitiveness and economic performance in an era of increased globalization.

Given the impact insolvency laws have on the economy, periodic reform is essential to ensure that these laws continue to operate in a fair and efficient manner and continue to meet the objectives they were designed to achieve.

A number of fundamental principles are essential to a well-functioning insolvency system: (i) fairness, as insufficient assets exist to satisfy all claims; (ii) predictability, because market players must be able to assess risks; (iii) transparency, as creditors must be equipped to defend their interests; and (iv) efficiency, in order to provide proper incentives while deterring abuses.

Canada's Insolvency Laws

Canada's insolvency system relies on two main statutes: the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA), each with distinct elements and purposes. The BIA provides a legislative framework to address both personal and corporate insolvency situations, whether a bankruptcy or a restructuring of a debtor's financial affairs. In the event of a personal or corporate bankruptcy, the Act provides for the liquidation of the bankrupt's assets by a trustee-in- bankruptcy and the distribution of the proceeds in a fair and orderly manner among the creditors. Alternatively, the BIA provides a mechanism for the consumer or business debtor to avoid bankruptcy by negotiating an arrangement with their creditors to reorganize the debtor's

financial affairs (called a "proposal").

For its part, the CCAA provides a legislative framework for the reorganization of insolvent corporate debtors under Court supervision. It does so by enabling an insolvent company to seek a Court order staying its creditors from taking action against it while it attempts to negotiate an arrangement with them for the rescheduling or compromise of its debts. In order to reorganize under the CCAA, a company must have more than $5 million in debt. While these reorganizations could also proceed under the BIA as a proposal, the CCAA process is largely court-driven, which allows a high degree of flexibility in dealing with the specific situations.

Review and Consultations

In order to ensure that Canada's insolvency laws continued to meet their objectives, a lengthy and comprehensive consultation process was undertaken by Industry Canada in 2001 and 2002. In addition, following the Industry Canada process, the Standing Senate Committee on Banking, Trade and Commerce conducted public consultations and issued recommendations in a report dated November 2003, "Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*." Based on the consultation process and following a review of the Senate Committee's recommendations, a Bill was prepared and was passed by the previous Parliament. On receiving Royal Assent, this Bill was renamed Chapter 47 of the Statutes of Canada, 2005.

Chapter 47's Policy Objectives

Chapter 47 had four main objectives: (i) to facilitate the restructuring of viable but financially troubled companies, (ii) to better protect claims for unpaid wages, (iii) to make the insolvency system fairer and reduce abuse, and (iv) to improve the administration of the insolvency system.

While a number of important technical deficiencies were identified during the Parliamentary review of the Bill that became Chapter 47, corrective amendments were not adopted prior to Royal Assent on November 25, 2005. Therefore, new legislation is required to make corrective amendments before the coming into force of Chapter 47. The proposed amendments to Chapter 47 are technical in nature and are intended to ensure that the objectives of Chapter 47 are achieved.

Key Amendments:

Commercial Issues:

Receiverships: Chapter 47 created the concept of a receiver with the authority to act nationally. While this will increase the efficiency of the insolvency regime, concerns were expressed that it is necessary to specify the powers the court may grant to the receiver and to require that there be a connection between the supervising court and the debtor's operations. Without these technical amendments, there may be uncertainty as to the powers that the national receiver may exercise. Moreover, the powers may differ between jurisdictions if courts develop their own rules to fill the gap in the legislation. In addition, the appointment of a receiver should be brought in the locality of the debtor to increase the opportunity for small creditors to have better access to the court without incurring the costs associated with hiring counsel in other jurisdictions.

Trustee liabilities: the Chapter 47 reforms were intended to override recent case law that opened the door for personal liability to be imposed on insolvency professionals with respect to certain pre-existing obligations of the debtor. The reforms need to be further clarified so that parties and the court understand that trustees are not to be held personally liable for debts or obligations created by the debtor's conduct prior to the appointment of the insolvency professional. Without the

protection, insolvency professionals may be unwilling to take files where the risk of personal liability is too great. This would result in more liquidations, with the attendant loss of jobs and value for creditors. The reforms are intended to encourage insolvency professionals to participate in restructurings and going concern asset sales.

Equity claims: under Chapter 47, claims relating to ownership interests in debtor entities (represented by company shares for example) were subordinated to the claims of other creditors. Chapter 47 will be amended to clarify that all claims related to the ownership interest, such as claims for dividends, redemption rights, loss of value due to misrepresentations and indemnity claims against the debtor for such losses, are subordinated to other creditors and that such stakeholders should not be entitled to defeat a restructuring arrangement. Failing to make the clarification may result in only a partial implementation of the policy intention of subordinating the claims of shareholders.

Transfers at undervalue: strategic debtors may dispose of assets prior to an insolvency filing to defeat the interests of their creditors. It has become clear that the Chapter 47 reforms, which intended to prevent such actions, would not achieve that objective. It is necessary to tighten the transfer at undervalue provisions by capturing all transfers of property and by clarifying that transfers to related parties will be subject to strict review.

Consumer Issues:

Family law issues: Chapter 47 reforms inadvertently removed some protections for family law related claims that could be the subject of fraudulent preference claims by other creditors. For example, spousal or child support payments made by the bankrupt under a court order or agreement may be found to be a preference which would require the recipient to repay the amount to the trustee. An amendment will clarify that this was not intended to apply to those types of payments.

Student loans: under current provisions of the BIA, student loan debts could not be discharged until 10 years after the completion of post-secondary education. The amendments in Chapter 47 will reduce the waiting period to seven years or, in the case of proven financial hardship, five years. This Chapter 47 provision inadvertently applied only to new bankrupts; however, it was always intended that it apply, for the reduction to seven years, to undischarged and new bankrupts and for the reduction to five years to all bankrupts regardless of when they became bankrupt. Without these changes, anyone who became bankrupt prior to the legislation coming into force would have to wait ten years before their student loans debt could be discharged.

Insolvency Reform and the Wage Earner Protection Program:
A Proposal to Protect Wage Earners

Chapter 47 also includes new measures to improve the protection of workers whose employers become bankrupt.

Under current insolvency laws, claims for unpaid wages rank lower than many creditors, including certain Crown claims, certain unpaid suppliers' claims, and all secured creditors. As a result, many workers receive no payment, as there are insufficient assets to satisfy their claims — even in part. Those workers who do receive payment generally receive only a portion of their claim. It is estimated that on average unpaid wage claims receive only 13 cents on the dollar under the present system. In addition, the payment of claims is usually made only at the conclusion of bankruptcy proceedings — a process that may take up to three years. It is estimated that between 10,000 and 20,000 workers have unpaid wage claims per year.

Chapter 47 put forward two measures to improve the protection of unpaid wage earners.

First, Chapter 47 introduced a Wage Earner Protection Program (WEPP) to provide for the payment of unpaid wages and earned vacation pay to employees whose employers become bankrupt or subject to a receivership. The WEPP will:

- provide guaranteed payment to each worker for unpaid wages and vacation pay, up to an amount equalling four weeks' maximum insurable earnings under the Employment Insurance (EI) Act (or approximately $3,000 at this time). Under existing provisions of the BIA, payment of wages depends on the liquidation value of the bankrupt employer's property. The WEPP payment will be subject to income tax and will take into account other appropriate deductions. It is estimated that the payment cap of approximately $3,000 at this time is sufficient to fully cover amounts owing for wages and vacation pay in 97% of cases;

- provide prompt payment of wages, so that workers receive their money when they need it most;

- be delivered in a seamless manner, by building upon the existing relationships between trustees and receivers, and the Employment Insurance system. Trustees and receivers would inform workers of the program and provide the documents necessary for unpaid workers to apply for payment;

- cost an estimated $35 million per year, reaching a maximum of $50 million per year;

- be funded from general federal revenues; and

- recoup the payments made by the Program, as fully as possible, by taking the place of the worker when assets are distributed through the bankruptcy process.

Second, Chapter 47 enacted a "limited super-priority" in the BIA for unpaid wage claims, which grants those claims a priority charge - ahead of secured creditors - over current assets (cash, accounts receivable and inventory). The limited super-priority will make more assets available for unpaid wage claims.

The super-priority supports and complements the WEPP. First, under the WEPP, the government will assume the interests of wage earners against the bankrupt employer, and will be able to recover a portion of the Program costs. It is estimated that the government will recover up to 50 cents on the dollar with the new limited super priority. In addition, the super-priority will deter employers from failing to pay workers with the expectation that the government will ensure payment. Secured lenders will have an incentive to monitor the behaviour of employers and take steps to ensure that they meet their payroll obligations, in order to prevent the accumulation of unpaid wage claims that may interfere with the secured interest. Finally, an individual who does not qualify for payment from the WEPP will be able to pursue the wage claim through the limited super priority and the existing preferred creditor status up to the $2,000 cap.

Technical amendments are also needed to ensure that the WEPP Act operates in the way it was originally intended.

Key Amendments to the WEPP Act:

Eligibility to the WEPP: under current provisions of the WEPP Act, wage earners who were employed for three months or less ineligible for the Program. This measure was intended to prevent abuse of the WEPP by employers who may hire workers in the period immediately preceding the bankruptcy or receivership without intending to pay them. However, it is recognized that this measure may unfairly penalize workers who have accepted a position with the employer in good faith in the

period leading up to the bankruptcy or receivership. It is therefore proposed that this provision be replaced with a new eligibility requirement that individuals who are not dealing at arm's length with key decision-makers in the business (which includes individuals who are related to the decision-makers) are ineligible. However, those relatives who are excluded will have the opportunity to establish that they have a legitimate employment contract with the employer that is unaffected by the relationship they have with the decision-maker. By doing so, they will make themselves eligible for the WEPP.

Payment of insolvency practitioners' fees and expenses: The WEPP Act requires trustees and receivers to perform duties to support the operation of the Program, including identifying unpaid wage earners, informing them of the WEPP, and providing information on wage claims to applicants and to the Program. The WEPP Act allows trustees and receivers to charge reasonable fees and expenses for performing these duties. However, in certain cases, there may be insufficient assets to pay those amounts. In such situations, insolvency professionals may decline to take on the case, which would prevent those wage earners from accessing the WEPP. This would create inequities among unpaid wage earners. As such, the policy intent of the Program, which is to protect vulnerable wage earners, could be undermined. Therefore, an amendment is proposed that would allow the WEPP to pay insolvency professionals, in certain cases and under certain conditions, for carrying out duties related to the operation of the WEPP.

Duty to assist: it is proposed that the WEPP Act be amended to require people who have payroll information, or who have access to payroll information, to assist trustees and receivers in performing their duties under the Act. Furthermore, the WEPP Act would also make it an offence to fail to comply with this duty. The amendment would improve the administration of the Program by allowing applicants to receive their payments more quickly.

Explicit defence of due diligence: the WEPP Act includes an offence provision for trustees and receivers, or any person required to assist trustees or receivers, who fail to comply with their duties under the Act. These provisions were included with the intent that they be considered "strict liability offences". Strict liability offences allow for a defence of due diligence. The defence was not explicitly provided for because it was expected that courts would recognize the offence as strict liability and allow a due diligence defence. However, to provide greater certainty and clarity, an explicit due diligence defence will be inserted into the Act.

Modifying WEPP payments: it is proposed to amend the WEPP Act so that Program payments reflect the deductions which would have been applied to workers' wages had they been paid in the normal course.

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All times are reflected in Atlantic time

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